SUSU LEMBU ASLI MARKETING SDN BHD

v.

DUTCH LADY MILK INDUSTRIES BHD

HIGH COURT MALAYA, KUALA LUMPUR
AZMEL MAAMOR J
[CIVIL SUIT NO: S6-22-190-2002]
16 OCTOBER 2003

ARBITRATION: *Stay of proceedings - Principles applicable - Whether requirements under s. 6 Arbitration Act 1952 satisfied – Whether there were sufficient reasons why matter should not be referred to arbitration - Arbitration Act 1952, s. 6*

CONTRACT: *Arbitration - Agreement referring to arbitration - Stay of proceedings - Principles applicable - Whether requirements under s. 6 Arbitration Act 1952 satisfied - Whether there were sufficient reasons why matter should not be referred to arbitration - Arbitration Act 1952, s. 6*

This was an application by the defendant for a stay of court proceedings pending reference made to arbitration regarding the validity of a production agreement between the defendant and plaintiff. In order to succeed under s. 6 of the Arbitration Act 1952 ('the Act'), an applicant must satisfy four requirements, namely: (i) that the legal proceedings have been commenced against the applicant in respect of a matter which has been agreed should be referred to arbitration; (ii) that no other steps in the proceedings be taken by the applicant before the making of the application for stay; (iii) that there is no sufficient reason why the matter ought not to be referred to arbitration as agreed between the parties; and (iv) that the applicant was at the time of the application ready and able to do all things necessary for the proper conduct of the arbitration.

It was in respect of (iii) that the plaintiff strenuously argued that it had sufficient reasons as to why the matter should not be referred to arbitration. The plaintiff had given the following grounds in opposing the defendant's application for a stay of the proceedings: (a) that on a true and proper construction of the arbitration clause, the dispute of the parties did not fall within its scope; (b) that the arbitration clause was void and ineffective as the production agreement had been rescinded by the plaintiff; (c) that an arbitrator could not determine the scope of his own jurisdiction; (d) that the defendant's application, if allowed, would result in multiplicity of proceedings; (e) that the plaintiff had a *bona fide* allegation of fraud against the defendant and, hence,

a reference to arbitration would not be appropriate in accordance with s. 25 of the Act; and (f) that the arbitrator did not have the power to order rescission pursuant to s. 34 of the Specific Relief Act 1950.

Held:

[1] In respect of (i), the defendant had shown that the production agreement which became the subject matter of the dispute between the plaintiff and the defendant contained an arbitration clause, and that legal proceedings were commenced by the plaintiff when it filed the writ of summons against the defendant. (p 497 g)

[2] In respect of (ii), it was an undisputed fact the defendant had only entered its appearance. The defendant had not even filed the statement of defence, and in light of such facts, it was clear that the defendant had not taken any steps in the proceedings yet. (p 497 h)

[3] In respect of (a), the dispute between the plaintiff and defendant would come within the scope of the arbitration clause as provided under the production agreement even though the plaintiff had alleged that the production agreement was induced by fraud or misrepresentation by the defendant. Rescission of the production agreement could not be possible because the plaintiff could not restore the original position of defendant before the production agreement was signed. The words "arising from" in the 2nd limb of the arbitration clause were also sufficiently wide to cover the determination of the dispute as to whether the production agreement was induced by fraud or misrepresentation. (p 500 a-c)

[3a] In respect of (b), even if the production agreement were *void ab initio* for the various reasons as alleged by the plaintiff, the arbitration clause would survive and remain effective. The arbitration clause was an autonomous agreement independent from the production agreement and plaintiff had not raised any issue or made any allegation on the validity of the arbitration clause. Therefore, there was no merit in the plaintiff's contention. (pp 500 h & 5001 a-b)

[3b] In respect of (c), the issue of whether the production agreement was *void ab initio* should be a dispute 'arising from" the production agreement and/or "connected with" the production agreement within the ambit of the 2nd limb of the arbitration clause. The arbitration clause, therefore, empowered the arbitrator to finally deal with such a matter.
(p 501 g-h)

[3c] In respect of (d), the question of multiplicity of proceedings did not arise since the arbitrator was empowered to adjudicate both causes of action. (p 502 b-c)

[3d] In respect of (e), the plaintiff had failed to give any good reason as to why the dispute should not be referred to arbitration. On the other hand, the defendant had shown concern of the likelihood of negative publicity causing irreparable damage to the defendant's commercial reputation if the dispute was to be heard in open court. (p 503 b-c)

[3e] In respect of (f), an arbitrator appointed pursuant to the arbitration clause as contained in the production agreement would have the power to decide whether the plaintiff's rescission of the production agreement was valid or otherwise. (p 503 h)

[3f] In light of the facts and circumstances above, the defendant had also satisfied (iii). (p 504 a)

[4] In respect of (iv), there was no doubt that the defendant remained ready and able to do all things necessary for the proper conduct of the arbitration. (p 504 a-b)

[Application allowed.]

Case(s) referred to:

Abdul Razak Datuk Abu Samah v. Shah Alam Properties Sdn Bhd [1999] 3 CLJ 231 ***(refd)***

Ashville Investments Ltd v. Elmer Contractors Ltd [1988] 2 All ER 577 ***(foll)***

Cunningham-Reid & Anor v. Buchanan-Jardine [1988] 2 All ER 438 ***(refd)***

Harbour Assurance Co (UK) Ltd v. Kansa General International Assurance Co Ltd [1993] 3 All ER 897 ***(foll)***

Heyman & Anor v. Darwins Ltd [1942] 1 All ER 337 ***(foll)***

Northern Regional Helath Authority v. Derek Crouch Construction Co Ltd [1984] 2 All ER 175 ***(refd)***

Radford v. Hair & Anor [1971] 2 All ER 1089 ***(refd)***

Legislation referred to:

Arbitration Act 1952, ss. 6, 25
Contracts Act 1950, ss. 65, 66
Specific Relief 1950, s. 34(1)

For the plaintiff - Robert Low (HL Ooi & CK Yeoh); M/s Ranjit Ooi & Robert Low
For the defendant - CW Teo (YB Tan); M/s Khaw & Partners

Reported by Suresh Nathan

JUDGMENT

Azmel Maamor J:

On 10 October 2000 the plaintiff and the defendant in this case executed a production agreement under which the defendant agreed to manufacture, pack and supply for the plaintiff various dairy products and in return for these works the plaintiff agreed to pay the defendant the charges at the rates agreed between the two parties. During the initial period of the agreement everything appeared to have worked fine between the two parties. However, commencing from August 2001 the plaintiff failed to make payments for products supplied by the defendant. On 4 January 2002 the defendant issued a demand letter to the plaintiff asking for payment of a sum of RM4,381,780.98 for products supplied and delivered to the plaintiff.

Subsequently on 5 February 2002 the plaintiff issued a letter to the defendant purporting:

(1) to rescind the production agreement on the grounds that the plaintiff's consent thereto was vitiated by fraud and/or misrepresentation on the part of the defendant; and

(2) alternatively, to terminate the production agreement on account of breach of the term thereof.

On 8 February 2002 the defendant sent a reply to the plaintiff's letter categorically refuting the plaintiff's right to rescind or terminate the production agreement or to claim damages from the defendant. At the same time the defendant reminded the plaintiff that the production agreement still subsisted.

On 26 February 2002 the plaintiff filed in court a writ of summons and statement of claim against the defendant. After entering an appearance the defendant made an application for a stay of the court proceedings pending reference made to the arbitration. (encl. 14A). The defendant's application to refer to the arbitration is based on cl. 13 of the production agreement which provided:

> **13. ARBITRATION**
>
> Any dispute or difference which may arise between the PARITES at any time hereafter whether during the continuance in force of this Agreement or upon its termination, touching any matter or thing therein contained or the operation or construction of this Agreement or any matter or thing in any way connected with, arising from or in relation to this Agreement or the rights, duties, liabilities of the PARTIES hereunder shall be finally settled by arbitration in accordance with the Arbitration Act 1952 (Revised 1972).

The Arbitration Act 1952 makes provision for any party to apply for a stay of proceedings where there is submission to arbitration. This is contained under s. 6 of the said Act, which reads:

> If any party to an arbitration agreement or any person claiming through or under him commences any legal proceedings against any other party to the arbitration, or any person claiming through or under him, in respect of any matter agreed to be referred to arbitration, any party to the legal proceedings may, before taking any other steps in the proceedings, apply to the court to stay the proceedings, and the court, if satisfied that there is no sufficient reason why the matter should not be referred in accordance with the arbitration agreement, and that the applicant was at the time when the proceedings were commenced and still remains ready and willing to do all things necessary to the proper conduct of the arbitration, may make an order staying the proceedings.

It has been a well established principle that in order to succeed under s. 6 of the said Act the applicant must satisfy four requirements, namely:

(1) that the legal proceedings have been commenced against the applicant in respect of a matter which has been agreed should be referred to arbitration;

(2) that no other steps in the proceedings be taken by the applicant before the making of the application for stay;

(3) that there is no sufficient reason why the matter ought not to be referred to arbitration as agreed between the parties; and

(4) that the applicant was at the time of the application, remains ready and able to do all things necessary for the proper conduct of the arbitration.

In respect of the 1st requirement I was quite satisfied that the defendant had shown that the production agreement which became the subject matter of dispute between the plaintiff and the defendant contained an arbitration clause as provided by cl. 13 (referred to above). I was also satisfied that this legal proceedings were commenced by the plaintiff by filing the writ of summons against the defendant on 26 February 2002 in this court.

In respect of the 2nd requirement it was an undisputed fact that in this court proceedings all that the defendant had done was only entering of its appearance. The defendant had not even filed the statement of defence. In the light of such facts I ruled that the defendant had not taken any steps in the proceedings yet.

It was in respect of the 3rd requirement that the plaintiff strenuously argued that it had more than sufficient reasons why the matter should not be referred to arbitration. The plaintiff had given the following grounds in opposing the defendant's application for a stay of the proceedings:

1. that on a true and proper construction of the arbitration clause, the dispute between the parties therein does not fall within its scope;
2. that the arbitration clause is void and ineffective as the production agreement has been rescinded by the plaintiff;
3. that an arbitrator cannot determine the scope of his own jurisdiction;
4. that the defendant's application, if allowed, would result in multiplicity of proceedings;
5. that the plaintiff has a *bona fide* allegation of fraud against the defendant and hence a reference to arbitration would not be appropriate in accordance with s. 25 of the Arbitration Act 1952; and
6. that the arbitrator does not have the power to order rescission pursuant to s. 34 of the Specific Relief 1950.

In respect of the 1st ground, the plaintiff alleged that the plaintiff's consent to the production agreement was vitiated by fraud or misrepresentation on the part of the defendant. The plaintiff contended that the arbitration clause requires the production agreement to be in existence for it to be applicable.

Since the production agreement was to be treated as never coming into existence in the first place since it has been rescinded ab initio by the plaintiff, the arbitration clause is not applicable.

In reply, the defendant submitted that it is trite law that the remedy of rescission aims at **restoring** the contracting parties as much as possible to their original position as existed before the contract was signed. As such the right to rescind would be lost if the restitution is no longer possible. The defendant further submitted that the rescission of a voidable contract should conform to the provisions of ss. 65 and 66 of the Contracts Act 1950, in that it must have the following consequences:

1. the contract need not be performed by either party;
2. the innocent party must restore any benefit received by him under the contract to whom it was received; and

3. any person who has received any advantage under the contract must restore it or make compensation for it to the person from whom he received it.

In support of its contention the defendant referred to the Court of Appeal case of *Abdul Razak Datuk Abu Samah v. Shah Alam Properties Sdn Bhd* [1999] 3 CLJ 231 where Gopal Sri Ram JCA said:

> An action for rescission may be met by any equitable defences available against the claims for other form of specific relief, e.g. a plea of affirmation or laches or a plea that damages are an adequate remedy. Rescission may also be refused by a court on the ground that restitutio in integrum is not possible because e.g. an innocent third party's rights have been intervened in the interim.

Based on the authorities it had cited, the defendant contended that the plaintiff could only rescind the production agreement *ab initio* if the plaintiff could not restore to the defendant all the benefits the plaintiff had received under the production agreement. The defendant had listed the following benefits that the plaintiff had received from the defendant by virtue of the production agreement:

1. The defendant had manufactured, packed and supplied to the plaintiff various dairy products under the production agreement since 10 October 2001;

2. The defendant had supplied dairy products to the plaintiff who then distributed and sold the same to its customers and these dairy products have been consumed by the plaintiff's customers; and

3. The plaintiff still owed a substantial debt to the defendant for the dairy products taken delivery by the plaintiff pursuant to the terms of the production agreement.

As to the plaintiffs allegation of fraud and misrepresentation committed by the defendant thereby resulting in the dispute no longer falling within the scope of the arbitration clause, the defendant replied that the question as to whether the plaintiff was induced to enter into the production agreement by fraud or misrepresentation was a "dispute or difference" coming within the scope of the 2nd limb of the arbitration clause particularly the usage of the words "arising from" which have similar meaning with the words "arising out". The defendant referred to the case of *Ashville Investments Ltd v. Elmer Contractors Ltd.* [1988] 2 All ER 577 where the English Court of Appeal held that the disputes between the parties over a mistake made by one or both parties at the time when the contract was entered into or over a misrepresentation or negligent mistatement made by one party were disputes arising "in connection" with the contract and therefore fell within the scope of the arbitration clause.

Based on the submissions before me I arrived at the conclusion that the disputes between the plaintiff and the defendant would come within the scope of the arbitration clause as provided under the production agreement even though the plaintiff had alleged that the production agreement was induced by fraud or misrepresentation by the defendant. Rescission of the production agreement could not be possible because the plaintiff could not restore the original position of the defendant as it was before the production agreement was signed.

I was also satisfied that the words "arising from" in the 2nd limb of the arbitration clause are sufficiently wide to cover the determination of dispute as to whether the production agreement was induced by fraud or misrepresentation.

In its 2nd ground, the plaintiff contended that the arbitration clause was void and ineffective as the production agreement had been avoided. In reply the Defendant referred the English case of *Hevman and Anor v. Darwins Ltd.* [1942] 1 All ER 337 where Lord Porter said:

> If two parties purport to enter into a contract and a dispute arises as to whether they have done so or not, or as to whether the alleged contract is binding upon them, I see no reason why they should not submit that dispute to arbitration ..... collateral to the agreement

The defendant also referred to the case of *Harbour Assurance Co (UK) Ltd. v. Kansa General International Assurance Co Ltd* [1993] 3 All ER 897, where the English Court of Appeal held that:

1. an arbitration agreement, if sufficiently widely drawn, may include a dispute about the initial illegality of the contract and one contracting party ought not prevent an arbitration from taking any place simply by alleging that the contract was void for initial illegality;

2. under the doctrine of separability, the arbitration agreement being a self-contained contract collateral to the principal/containing contract, if not directly impeached, will survive the invalidity of the principal/containing contract; and

3. an arbitrator is not prevented from determining an issue of initial illegality of a contract.

In rejecting the plaintiff's 2nd ground, the defendant contended as follows:

1. Even if the production agreement was *void ab initio* for the various reasons alleged by the plaintiff, the arbitration clause will survive and remain effective;

2. The arbitration clause is an autonomous agreement independent from the production agreement; and

3. The plaintiff had not raised any issue or make any allegation on the validity of the arbitration clause eg, whether the plaintiff's consent to the arbitration clause (not the production agreement) was induced by fraudulent misrepresentation.

In my consideration of this plaintiff's 2nd ground, I agreed fully with the submission given by defendant's counsel. I therefore concluded that there was no merit in the plaintiff's contention.

On the contention that an arbitrator cannot determine the scope of his own jurisdiction which the plaintiff had relied as the basis of its 3rd ground, the defendant submitted that under the doctrine of separability of arbitration agreement, when the validity of the arbitration agreement is not an issue ie, impeached, the arbitrator is prevented from determining an issue of initial invalidity of a contract which contained the arbitration agreement. In the case of *Hevman and Anor v. Darwins Ltd* [1942] 1 All ER 337, Lord Wright said as follows:

> I should prefer to put it that the existence of his jurisdiction in this as in other cases is to be determined by the words of the submission. **I see no objection to a submission of the question whether there ever was a contract at all, or whether, if there was, it has been avoided or ended. Parties may submit to arbitration any or almost any question**. In general, however, the submission is limited to question arising upon or under or out of contract which would *prima facie*, include questions whether it has been ended and, if so whether damages are recoverable, and if recoverable, what is the amount.
>
> (emphasis added).

Based on the principle of the above stated case as well as the fact that the plaintiff had not challenged the validity of the arbitration clause, the defendant submitted that the issue whether the production agreement is *void ab initio* should be a dispute "arising from" the production agreement and/or "connected with" the production agreement within the ambit of the 2nd limb of the arbitration clause. The arbitration clause therefore empowers an arbitrator to finally deal with such matter.

I was in full agreement with the contention given by the defendant's counsel.

Under its 4th ground, the plaintiff contended that the defendant's application, if allowed, would result in multiplicity of proceedings. Under this ground the plaintiff submitted that its main cause of action against the defendant was the

fraud and for the reason thereof the plaintiff had the right to rescind the production agreement. And the plaintiffs alternative cause of action was the defendant's fundamental breach of the production agreement and such breach would justify the plaintiff to terminate the production agreement. It was argued by the plaintiff that even if the alternative cause of action falls within the arbitration clause, the two causes of action should not be split by referring the alternative cause of action to arbitration and leaving the main cause of action with the court resulting in multiplicity of proceedings.

It was my conclusion that this 4th ground of the plaintiff should be summarily dismissed since as discussed earlier the arbitrator is empowered to adjudicate both causes of action. Hence the question of multiplicity of proceedings did not arise.

As to its 5th ground, the plaintiff contended that there existed an issue of fraud against the defendant and hence a reference to arbitration would not be appropriate. However the various authorities referred by the defendant do not appear to support the plaintiff's contention.

In *Radford v. Hair & Anor* [1971] 2 All ER 1089 where the plaintiff opposed the defendant's application for a stay of proceedings on the ground that the defendant had made various allegations impugning the plaintiff's professional reputation. The court held that because the allegations were akin to allegations of fraud against the plaintiff and against such allegations, the plaintiff was entitled to have his case tried by a judge in open court.

In the case of *Cunningham-Reid and Anor v. Buchanan-Jardine* [1988] 2 All ER 438, the English Court of Appeal made the following principles:

1. Where a party accused of fraud opposed a stay of proceedings, the court would almost invariably refuse a stay; and

2. Where the party alleging fraud opposed a stay and the party accused of fraud wished to proceed to arbitration, the allegation of fraud was not by itself sufficient reason for the court to refuse a stay. Instead the court had discretion dependent on all the circumstances of the case.

In the same case Bingham LJ said:

> The fact that an apparently strong case exists is a consideration relevant to the exercise of the Court's discretion but one that can only be entertained with full recognition that the case has not been tried and that the defendant's contentions have not been disclosed, let alone investigated there is no rule that it is appropriate to retain a case in the High Court because a charge of fraud is made against a professional or quasi-professional whether that person

> does not wish trial in open Court ... . The defendant here wants to arbitrate and is entitled by virtue of the agreement to arbitrate unless good reasons exist against the course. In my judgment there is no such good reason and the judge gave quite insufficient weight to the arbitration agreement, which is, in the language sometimes used by continental lawyers, the law between the parties.

On this issue, it was my finding that the plaintiff had failed to give any good reasons as to why the disputes should not be referred to arbitration. On the other hand the defendant had shown concern of likelihood of negative publicity that may befall the defendant with the likelihood of causing irreparable damage to the defendant's commercial reputation if the disputes were to be heard in the open court. I therefore decided to exercise my discretion in favour of the defendant.

Finally, the plaintiff contended that the arbitrator does not have the power to order rescission pursuant to s. 34(1) of the Specific Relief Act 1950.

In reply the defendant submitted that s. 34(1) of the Specific Relief Act 1950 is merely a permissive and not a mandatory provision by the use of the word "may". Therefore it does not prohibit other tribunal from deciding whether there is a valid rescission of an agreement.

In support of such contention the defendant referred to the case of *Ashville Investments Ltd v. Elmer Construction (supra)* where Balcombe LJ, in considering the issue whether an arbitrator would have power to decide on the issue of a rescission of an agreement, held:

> The approach is summarised in the following proposition: (i) it is to be presumed that the parties intended to refer all the disputes arising out of a particular transaction to arbitration; (ii) it may also be presumed that the parties intended that all disputes should be determined finally by the same tribunal; and (Hi) as a result of the decision in *Northern Regional Health Authority v. Derek Crouch Construction Co Ltd* [1984] 2 All ER 175, [1984] QB 644 it is clear that an arbitrator may have powers which are not available to the Court. Therefore he should have those powers which are available to the Court.

Based on the above arguments submitted by the defendant I was quite convinced that an arbitrator appointed pursuant to the arbitration clause as contained in the production agreement would have the power to decide whether the plaintiff's rescission of the production agreement was valid or otherwise. As such I also ruled that this 6th ground of the plaintiff should also fail.

In the light of the above facts and circumstances I came to the conclusion that the defendant had also satisfied the 3rd requirement.

As regards the 4th requirement there were no doubts in my mind that the defendant remained ready and able to do all things necessary for the proper conduct of the arbitration. In fact the plaintiff did not appear to dispute this fact. As such the defendant had managed to satisfy all the four requirements.

In the light of the circumstances as mentioned above I allowed the defendant's application for a stay of proceedings pending arbitration. I also ordered that the cost of this application be borne and paid by the plaintiff.